



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

DRAFT

Date Introduced:	02/18/05	Bill No:	SCA 9
Tax:	Business, Property, Income	Author:	Ducheny
Related Bills:	AB 1026 (Horton) AB 1615 (Klehs) ACA 14 (DeVore) SB 216 (Dutton)		

BILL SUMMARY

This constitutional amendment, if approved by the voters, would rename the Board of Equalization (BOE) as the California Tax Commission (CTC) and increase the membership to 9 voting members, as provided. In addition, this constitutional amendment would require the CTC to collect and administer income taxes and any taxes withheld from wages, and to conduct administrative review of state tax matter determinations.

ANALYSIS

Current Law

Under existing law, the BOE administers, among other programs, the following tax and fee programs: sales and use tax, Bradley-Burns uniform local sales and use tax, transactions and use tax, alcoholic beverage tax, cigarette and tobacco products tax, motor vehicle fuel tax, diesel fuel tax, interstate user tax, emergency telephone users surcharge, energy resources surcharge, insurance tax, integrated waste management fee, natural gas surcharge, childhood lead poisoning prevention fee, oil spill response and prevention fee, underground storage tank maintenance fee, use fuel tax, hazardous substances tax, California tire fee, occupational lead poisoning prevention fee, marine invasive species fee, electronic waste recycling fee, timber yield tax and private railroad car tax. The BOE also assesses the property of public utilities and common carriers, and provides certain administrative and oversight functions with respect to the local property tax.

The BOE is comprised of four elected members, one from each equalization district, and the State Controller. The Board itself is responsible for setting the values for state-assessed properties on the Board roll and for hearing appeals of those values. It also hears appeals relating to all of the taxes and fees it administers, as well as the taxes administered by the Franchise Tax Board (FTB).

The FTB was created by statute and is comprised of the Controller, the Director of Finance, and the Chair of the BOE. It administers the personal income tax and the

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corporation tax. In addition, the FTB administers other non-income tax related programs, including the Homeowners and Renters Property Tax Assistance program, child support and other non-tax debt collection programs, Political Reform Audit, and the Non-admitted Insurance Tax program.

The FTB and the BOE adopt rules and regulations for the taxes that the respective agencies administer. In addition, the BOE prescribes rules and regulations to govern county assessors when assessing property and assessment appeals boards when equalizing property values.

The Employment Development Department (EDD) was also created by statute. The EDD is responsible for collecting and maintaining significant data regarding employment and wages. The Tax Branch of the EDD manages all administrative, education, customer service, and enforcement functions for the audit and collection of California's payroll tax program. The program consists of Unemployment Insurance and Employment Training Tax, which are employer contributions, and Disability Insurance and Personal Income Tax, which are withheld from employees' wages.

Proposed Law

This proposed constitutional amendment, if approved by the voters, would amend the California Constitution to do the following:

- Rename the BOE as the CTC.
- Specify that the CTC would consist of nine voting members: the Controller, one member appointed by the Governor, and seven members elected for four-year terms at gubernatorial elections.
- Specify that the state shall be divided into seven CTC districts, as established by the Legislature.
- Specify that a CTC member shall not serve more than two terms.
- Require the CTC, in addition to performing the duties of the former BOE, to collect and administer taxes on or measured by income that are imposed on persons, corporations, or other entities as prescribed by law and any taxes that are withheld from wages. The CTC would also conduct administrative review of state tax matter determinations.

In General

The BOE, FTB, and the Tax Branch of the EDD, in December 1993, formed a Strategic Tax Partnership (STP) to do the following: (1) address any significant differences in policies, procedures, or standards among the state's three taxing agencies; (2) improve service to California's taxpayers; and (3) increase compliance with the state's tax laws. The STP is modeled on the concept of a virtual organization - a network of independent organizations linked to share skills, costs, knowledge, and resources, while maintaining their independent organizational forms.

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In 1994, the Legislature and the Governor provided additional direction to the STP in the 1994 Budget Act that required the partner agencies to develop a plan for integrating tax information systems and explore joint business ventures to improve sharing of information, increase tax compliance, reduce the reporting burden on taxpayers, and provide greater taxpayer convenience.

The first task of the STP, with participation from the Department of Finance and the Legislative Analyst's Office (LAO), was the development of a strategic plan. The plan identified the STP's vision, shared values, initial joint projects, and served as their road map. Over the years, the STP has accomplished the goals as identified in the plan.

In May 1994, the BOE, FTB, EDD, and the Internal Revenue Service (IRS) formed a task force, known as the "Fed/State Compliance 2000." The task force identified common interests and developed strategies to improve tax compliance, staff training, and taxpayer/tax preparer education. In 1995, the BOE became a member of the "Fed/State Partnership" which consists of the State's three taxing agencies—BOE, FTB, EDD, -- and the IRS. The Fed/State Partnership has developed strategies to increase tax compliance, reduce administrative costs, and reduce taxpayer/third party tax burden. To date, the Fed/State Partnership works on improving voluntary and enforced compliance, reducing taxpayer burden, enhancing service to taxpayers, and allowing both the state agencies and the IRS to perform their duties more efficiently and cost-effectively, while ensuring the protection of taxpayers' rights to privacy and confidentiality.

Background

The most recent proposed constitutional amendment that would have consolidated the FTB into the BOE was ACA 22 (Dutra, et al.), which was introduced during the 2003-04 Legislative Session. ACA 22 is similar to this bill, except it would have renamed the BOE as the "California Tax Board" (CTB), and would have maintained a membership level of five voting members (as opposed to a nine member commission SCA 9 is proposing). Also, ACA 22 would not have required the CTB to administer and collect the taxes withheld from wages, as SCA 9 would provide. ACA 22 was held in the Assembly Revenue and Taxation Committee.

Several other bills and proposed constitutional amendments have been introduced over the years that have proposed to merge the FTB *into* the BOE. These include:

- **AB 2000 (Dutton, 2003-04)** would have abolished the FTB and would have transferred all of its duties and powers to the BOE. The bill was held in the Assembly Revenue and Taxation Committee.
- **ACA 13 (Leonard, 2001-02)**, would have changed the name of the BOE to the California Tax Commission and required the new Commission, in addition to performing the duties of the former BOE, to administer and collect taxes on income as prescribed by law. ACA 13 was held in the Assembly Appropriations Committee.

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- **AB 15 (Klehs, et al., 1993-94)**, would have abolished the FTB and transferred its powers and duties to the BOE. This bill was vetoed by Governor Wilson. In part, the veto message states, "...I support streamlining government and consolidating the Board of Equalization and the Franchise Tax Board. AB 15 is not the way to accomplish this purpose. The Administration sponsored legislation that would have created a Department of Revenue within the Administration. That approach would avoid the conflict of interest inherent in AB 15, in which the Board of Equalization serves as both administrator of the tax system, as well as the appellate body for taxpayer appeals."
- **AB 3338 (McClintock, 1991-92)**, would have abolished the FTB and transferred its powers and duties to the BOE. This bill failed passage in the Assembly Revenue and Taxation Committee.
- **SB 1052/SCA 22 (Alquist, 1989-90)**, would have abolished the FTB and transferred its powers and duties to the BOE. SCA 22 would have added the Director of Finance (DOF) to the membership of the BOE. These bills were never heard in committee.

Other bills have also been introduced that would have consolidated the FTB and the BOE into another entity:

- **AB 2794 (Bowen, et al., 1995-96)**, would have abolished the FTB and, except as provided by the Constitution, the administrative authority of the BOE, and would have provided for the transfer of their respective powers and duties to the Department of Revenue (DOR), which this bill would have created. This bill would have also created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. This bill failed passage in the Assembly Revenue and Taxation Committee.
- **SB 1727/SCA 29 (Kopp, 1995-96)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the California State Tax Authority, which this bill would have created; and (2) created a Board of Tax Appeals consisting of seven members appointed by the Governor to serve as an appellate body to hear all tax appeals. Both bills were held in the Senate Appropriations Committee.
- **SB 87/SCA 5 (Kopp, 1993-94)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. SB 87 failed on the Senate floor. SCA 5 was placed on the Senate inactive file.
- **SB 1829 (Campbell, 1993-94)**, would have, among other things, consolidated the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created. The BOE would have provided administrative appellate review of all administrative tax matter decisions made by the DOR. This bill was never heard in committee.
- **SB 2137 (Campbell and Kopp, 1993-94)**, would have, among other things, consolidated the FTB and the BOE and transferred their powers and duties to the

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DOR, which the bill would have created. This bill would have also provided that the BOE would serve as the administrative appellate review of all administrative tax matter decisions made by the DOR. This bill failed passage in the Senate Appropriations Committee.

- **SB 23 (Kopp, 1991-92)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. This bill failed to move out of the Senate.
- **SB 1695 (Kopp, 1991-92)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. SB 1695 was sent to interim study. The Assembly Revenue and Taxation Committee held an oversight hearing on February 24, 1992, which reviewed specific issues related to consolidating the FTB and the BOE into a DOR. The issues discussed included: administration, audit, collections, return processing, legal divisions/appeals process, facilities, and data processing. It was noted in the hearing that the state's budget crisis made consolidation less attractive at the time due to its costs and complexities.
- **SB 1395 (Kopp, Ayala, et al., 1989-90)**, would have, among other things, done the following: (1) abolished the FTB and the BOE and transferred their powers and duties to the DOR, which the bill would have created; and (2) created a Board of Tax Appeals. This bill failed passage in the Senate Appropriations Committee.

COMMENTS

1. **Sponsor and purpose.** This measure is sponsored by the author and is intended to make California's government more efficient.
2. **LAO conducted a study regarding consolidation of certain functions of the BOE, FTB, and EDD.** Chapter 569, Statutes of 2003 (AB 986, Horton), directed the LAO to prepare a report that addresses issues related to the partial consolidation of FTB, BOE, and EDD. The legislation mandated that the LAO report to the Legislature regarding the possible consolidation of payment and document processing of these three agencies. Specifically, based on information provided by the tax agencies, the LAO was required to determine if it would be beneficial to consolidate the management and control of these operations.

In its January 2005 report, the LAO concluded that consolidation of the tax agencies' payment and documentation processing activities, could in the medium- to long-term generate some annual cost savings and interest earnings through elimination of duplicative functions and increased efficiencies. However, the report indicates that the state would have to incur significant net costs in the short term to achieve these savings. In addition, the report indicates that such benefits are likely to be less than benefits from increasing electronic processing. The LAO recommended that low

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priority be given to consolidation of payment and document processing functions in favor of steps to increase electronic processing.

3. **The California Performance Review (CPR) also made its final recommendations to the Governor.** The Governor, by executive order, created the CPR to conduct a focused examination of California state government and to formulate and recommend practical changes to government agencies, programs and operations in order to reduce total costs of government operations, increase productivity, improve services, and make government more responsive and accountable to the public.

As part of the Governor's process to decide which CPR recommendations to pursue, Governor Schwarzenegger formed the CPR Commission. The Commission is independent and bipartisan consisting of leaders in the public, private, and non-profit sectors. In its November 2004 report, the Commission agreed with the recommendation that the tax administration functions, such as collection and monitoring, should be consolidated from the different tax collection agencies in order to streamline processes and enhance operations.

The Commission also noted that, although it supports an elected appellate body for tax adjudication functions, a further study should be undertaken to determine the appropriate governing structure for the other tax collection activities. The report recommends that such a study should consider, among other issues, the public's expectation of accountability and equity, as well as the role of the Executive Branch in tax collection responsibilities.

4. **Current Board Members would retain their positions and begin two new terms.** The bill would provide that a member of the CTC shall not serve more than two terms. If an election were held on November 6, 2006, it appears the current Board Members, if elected, would be entitled to serve two additional terms.
5. **Measure would appear to only transfer the EDD's responsibilities related to withholding.** The Tax Branch of EDD collects unemployment insurance and employment training tax, which are employer contributions, and disability insurance and personal income tax, which are withheld from employees' wages. With respect to these responsibilities, this proposed constitutional amendment would appear to transfer to the CTC only EDD's disability insurance and personal income tax withholding functions.
6. **A bill to statutorily implement the proposed constitutional amendment should accompany this measure.** For example, the Revenue and Taxation Code requires the FTB to collect and administer the income tax. This proposed constitutional amendment would be in conflict with the Revenue and Taxation Code, since the proposed CTC would be charged with that responsibility. Accordingly, in order to accomplish the transfer of duties and responsibilities from the FTB to the CTC, it is recommended that enabling legislation accompany this measure.
7. **This bill is silent regarding the administration of FTB's non-tax collection programs.** FTB administers certain programs that are not income taxes: child

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support collections, homeowners and renters assistance, court-ordered debt collections, non-admitted insurance collections, political reform audit, and other programs. It is unclear whether the author wishes to have these responsibilities transferred to the CTC or allocated to other state agencies.

8. **Bill should have a delayed operative date for the assumption of the duties of the CTC.** The proposed constitutional amendment, if approved by the voters, would become operative on the day after the voters approve it, leaving no time to transfer the new duties and responsibilities to the CTC. It is recommended that the measure be amended to specify that the transfer of duties to the CTC would become operative on the first day of the next January commencing more than a year after the voters' approval.
9. **Proponents of consolidation of the agencies have argued the following points on previous proposals:**
 - **Consolidation would reduce administrative costs in the long-term.** It would reduce administrative costs, since it would result in the consolidation of administrative and staff services, including personnel and training. Also, it would avoid duplication of collection efforts, fiscal duties, and mailing costs. Data processing operations could be consolidated. Proponents state that consolidation of the data processing operations of the tax agencies could provide for improved information management and produce economies of scale.
 - **Consolidation would provide uniform tax policy and administration.** It would assure citizens greater uniformity in the compliance and appeals processes and provide an opportunity to simplify and reduce regulations, and to reduce and standardize the number of taxpayer reports that need to be filed.
 - **Audits could be consolidated.** Some proponents argue that if the tax administration were consolidated into one agency, all taxes could be audited at the same time.
 - **Elected officials tend to be more responsive than an appointed body.** Proponents have argued that a consolidated tax agency should be administered by an elected body because elected officials are more responsive to the people than appointed officials. Section 15623 of the Government Code requires Board Members to investigate the administration, enforcement, and operation within their districts of all laws in which the administration and enforcement is vested with the BOE. As such, it is the Board Member's job to represent taxpayers and to make sure that BOE's tax programs are administered uniformly. With a representative tax administration, individual taxpayers can go directly to their Board Member for help with tax matters.
10. **The following arguments have been made against similar previous proposals:**
 - **There is no overwhelming reason to consolidate.** In an overall view of the arguments in favor of and against merging the taxing agencies, it appears there is no overwhelming reason to do so. The tax agencies are operating efficiently,

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and in today's environment, modern technology actually makes physical merging less critical. California has an outstanding record in the field of tax collection and administration. Since it is unclear whether the merge would result in significant improvements, it appears that it may not be warranted to incur the significant costs of merging or to risk any loss of revenue during the period of conversion.

- **Whether economies of scale would be realized is questionable.** Opponents of similar proposals in the past have noted that the contentions of greater economy are largely illusory. Unless certain programs were curtailed, there would still be essentially the same staff requirements and space requirements. As pointed out by the LAO, enhancing the electronic processing of returns and payments should be given priority over merging.
- **This measure only provides a framework for consolidation.** This constitutional amendment does not provide the specifics of how the three tax agencies would consolidate the tax administrative functions. Much more extensive statutory changes are necessary to ensure that the functions are consolidated in a way that ensures maximum long-term cost savings.

10. **Related legislation.** As of the date of this analysis, four other measures have been introduced to provide some form of consolidation. These are:

- AB 1026 (Horton), which would state the intent of the Legislature to streamline and consolidate the state tax collection agencies and increase fairness in the collection of taxes.
- AB 1615 (Klehs), which would transfer to the BOE the duties, powers, purposes, responsibilities, and jurisdiction of the FTB and the tax administrative functions of EDD and the California Department of Insurance (CDI).
- ACA 14 (DeVore), which is similar to this measure, except it would not transfer the administration of the EDD-administered withholding taxes to the proposed CTC, as this measure would provide.
- SB 216 (Dutton), which would also transfer to the BOE the duties, powers, purposes, responsibilities and jurisdiction of the FTB and the tax administrative functions of EDD and CDI – in substantially the same manner as AB 1615 (Klehs).

COST ESTIMATE

This proposed constitutional amendment in and of itself would not affect administrative costs, but rather the costs would be incurred if voters approve the measure. According to the LAO's January 2005 report, a potential long-term savings exists associated with the partial physical consolidation of the agencies' payment and document processing

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activities by reducing duplication, streamlining staffing, and making more efficient use of existing capital.

However, the LAO points out that these savings are likely to be achievable only through an up-front investment by the state in additional systems that allow the agencies' separate and distinct processes to function in a consolidated fashion. In addition, given that the agencies are at different levels of technological advancement, the LAO report notes that considerable additional investment may be necessary to avoid losing the technological edge that some agencies have achieved in their processing functions.

The amount of these savings could not be determined without an extensive, detailed study.

REVENUE ESTIMATE

This proposed constitutional amendment in and of itself would not affect the state's revenues. In general, the transfer of the tax collection and administration responsibilities of the income taxes and taxes withheld from wages to the BOE would not appear to have any effect on the state's revenues. It is possible, however, that a decrease in revenue could be experienced during the period of conversion as a result of the requirement to spend staff time developing the procedures for the new agency.

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